Public Finance Newsletter

Issue XII
September 2016

In this issue

Dear readers,

In his book *Public Finance and Public Policy* (2004), Dr Jonathan Gruber defined public finance in very simple terms as 'the study of the role of the government in the economy.' Public finance is an important branch of economics as the government plays a crucial role in the economy by bringing in the potential for efficiency improvement where the market economy does not lead to the required efficiency—maximising outcome (market failure) and redistributing resources to establish equity and equality in society.

Given the importance of public finance and public policy in an economy, I am pleased to share knowledge and updates in the public finance domain through the 12th edition of our Public Finance Newsletter.

The feature article in this issue examines some of the key estimates of the Government of India's budget for FY 2016–17. The article assesses the estimates through a comparison of the budget and actual expenditure/revenues of the central government for the last five years. In the 'Pick of the quarter' section, the author analyses this year's 'State Finances: A Study of Budgets', which is an annual report published by the Reserve Bank of India.

'Round the corner' provides news updates in the area of government finances and policies across the globe and key paper releases in the public finance domain during the recent months, along with reference links. The 'Our work' section presents an overview of the *Systematic Review Programme for South Asia*, which aims to provide policymakers in South Asia with a robust assessment of the evidence base to help in policymaking and programme design.

You may read this newsletter on the go by downloading the PwC 365 app on your iOS and Android devices. The app is available on iTunes and Google Play. For more about PwC 365™, please visit https://www.pwc.in/publications/pwc-365-app.html

I would like to thank you for your overwhelming support and response. Your contributions have helped in making this newsletter an effective medium for sharing information.

We would like to invite you to contribute and share your experiences in the public sector and governance space with us. Do write to me at ranen.banerjee@in.pwc.com

Happy reading!

Sincerely,

Ranen Banerjee

Partner
Public Sector and Governance

Feature article

Union Budget 2016–17: How realistic are the estimates?

The budget is the most important policy document of a government and can be construed as a vehicle for driving the development of an economy. Implementing the budget as planned is an important factor in a government's ability to deliver the public services for the year as expressed in policy statements. Similarly, an accurate revenue forecast is important for efficient expenditure planning. An optimistic revenue forecast can result in expenditure exceeding the available resources, thereby leading to either borrowings or expenditure adjustments during the financial year and impacting allocative efficiency. On the other hand, a pessimistic revenue forecast may result in surplus resources which can potentially be used for spending that is not subject to the scrutiny of the budget process.

Considering the debate on the reliability of the numbers presented in a budget and the importance of realistically determining budget estimates (BE), this article analyses the reliability of some of the key estimates of the Government of India's budget for FY 2016–17.

To begin with, we have compared the actual receipts and expenditure of the central government with the budgetary estimates for the last five financial years (**Table 1**). As per the internationally accepted methodology for assessing public financial management practices (Public Expenditure and Financial Accountability Framework, 2011), a deviation of +/- 5% is given the best rating, i.e. 'A' (taking into consideration the outliers such as large expenditure required during drought).[1]

Table 1: Budget vs actual analysis for the last five years[2]

	2011–12	2012–13	2013–14	2014–15	2015–16*
Revenue side					
Total receipts (excluding loans)	-6.7%	-5.8%	-5.9%	-8.8%	2.3%
Revenue receipts	5.0%	-6.0%	-3.9%	-7.4%	5.7%
(i) Tax revenue (net to centre)	-5.2%	-3.8%	-7.7%	-7.5%	3.0%
(ii) Non-tax revenue	-3.0%	-16.6%	15.5%	-6.9%	16.6%
Capital receipts	18.2%	-4.3%	-10.5%	-7.1%	-8.9%
Expenditure side					
Total expenditure	3.7%	-5.4%	-6.4%	-7.3%	0.4%
(i) Non-plan expenditure	9.3%	2.8%	-0.3%	-1.5%	-0.3%
(ii) Plan expenditure	-6.6%	-20.6%	-18.4%	-19.5%	2.6%
(a) Revenue expenditure	4.4%	-3.3%	-4.5%	-6.4%	0.8%
(b) Capital expenditure	-1.2%	-18.5%	-18.1%	-13.3%	-1.5%

Source: Union Budget Documents, 2012-13 to 2016-17, *compared against revised estimates (the deviation is calculated as {(actual-budgeted)/budgeted]

[1] As per the framework, a country should be assigned an 'A' rating (which is the best) on expenditure out-turn if 'in no more than one out of the last three years has the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 5% of budgeted expenditure'.
[2] Throughout the document, the source is Union Budget Documents published annually, unless specified otherwise. Additionally, it should be noted that wherever 2015–16 figures are compared, these relate to revised estimates since actuals are not available.

As can be seen from **Table 1**, the actual total receipts as well as actual total expenditure have been lower than budgetary estimates for most of the last five-year period. For FY 2015–16, the revised estimates (RE) indicate that the Government of India's actual receipts and actual expenditure will be more aligned to budgetary estimates relative to performance in the preceding four years. However, it can be observed that only RE are available till now, which are generally upwardly biased. For the last four years (FY 2011–12 to FY 2014–15), the actual revenue/expenditure has generally been lower than the RE (**Table 2**).

Table 2: Actual vs RE, 2011–12 to 2014–15

	2011–12	2012–13	2013–14	2014–15
Revenue receipts	-2.03%	0.85%	-1.41%	-2.20%
Total expenditure	-1.09%	-1.43%	-1.95%	-1.04%
(i) Plan expenditure	-3.3%	-3.6%	-4.7%	-1.1%
(ii) Non-plan expenditure	0.0%	-0.5%	-0.8%	-1.0%

Source: Union Budget Documents, 2012-13 to 2015-16, (-) denotes under-collection/spending, (+) denotes over-collections/overspending

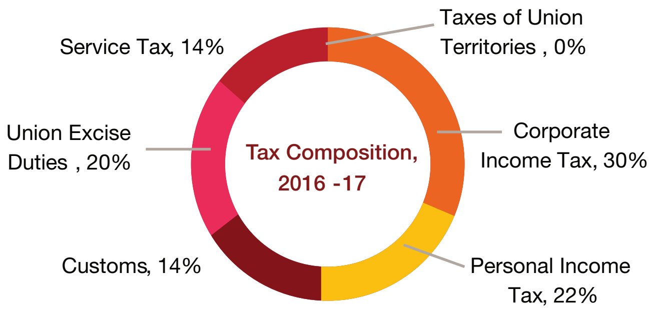
In the subsequent sections, we have analysed the BE vis- à-vis trends and underlying assumptions for FY 2016–17 in depth.

Revenue side

Tax revenue

The Government of India's projected tax revenue of nearly 16 lakh crore INR in 2016–17 is fairly distributed across five major sources—that is, corporate income tax (CIT), 30%; personal income tax (PIT), 22%; customs, 14%; union excise duties, 20%; and service tax, 14%, with the remaining coming from taxes in union territories (UTs).

Figure 1: Tax revenue composition, 2016-17 BE



Corporate income tax (30% share)

The tax is levied on the income of companies under the Income-tax Act, 1961. The CIT rates applicable on Indian companies are proposed to be reduced from the present 30% (*plus* surcharge, education cess, and secondary and higher education cess) level to 25% over the next four years in a phased manner, starting from FY 2016–17. Foreign companies (i.e. companies which are operating in India but are registered under the laws of a country other than India) are taxed at 40% (*plus* surcharge, education cess, and secondary and higher education cess).

The government has budgeted for 9% growth in the collection of CIT in FY 2016–17 vis-à-vis FY 2015–16 (RE). Nominal GDP is estimated to register an annual growth of 11% in FY 2016–17 as per the Union Budget of FY 2016–17.

The projected growth of 9% appears to be realistic based on buoyancy estimates calculated for the period after the financial crisis (**Table 3**) (9% = 0.8 CIT buoyancy * 11% of annual GDP growth rate).

Table 3: Buoyancy of CIT since 1998

	1998–2007	2008–2016
Buoyancy of CIT (in relation to nominal GDP)	2.07	0.8

However, it may be noted that expecting 9% growth in CIT collection on a base of generally optimistic REs of FY 2015–16 may lead to an upward bias in the projections, particularly given the experience of under-collections for CIT during the last five years relative to BE. The actual CIT collections were 10%, 5%, 6%, 5% and 4% lower than the BE in the last five years (FY 2011–12 actuals to FY 2015–16 RE), respectively.

Additionally, it is noteworthy that cumulative arrears under CIT as on the reporting period of 2014–15 were nearly 62% of the revenues collected in FY 2014–15. It is understandable that arrears recovery in dispute cases may take time. However, nearly 16% of the total arrears are undisputed. The Government of India has proposed a new Dispute Resolution Scheme, under which the taxpayer with a pending appeal before the Commissioner can settle her/his case by paying the disputed tax and interest up to the date of the assessment. Hence, if such tax arrears are collected, the expected growth in CIT collections will move upward in FY 2016–17.

Personal income tax (21% share)

In India, ordinary residents are taxed on their worldwide income. Non-resident Indians (NRIs) are taxed only on income that is received or deemed to be received in India, or which accrues or arises or is deemed to accrue or arise in India. A person who is a resident but not ordinary resident (RNOR) is taxed like an NRI, except that such a person is also liable to pay tax on income accruing abroad, if it arises from a business controlled, or a profession set up, in India.

The government has budgeted for 18% growth in PIT collections in FY2016–17 vis-à-vis FY2015–16 (RE). The projected growth is close to the long-term average growth of 17.4% (FY 1988–89 to FY 2015–16 [RE]). In comparison with CIT collections, the performance under PIT in terms of credibility of budgetary estimates has been better in the last five years (Table 4).

Table 4: Actual income tax collection vis-à-vis budgetary estimates in the last five years, FY 2011–12 to FY 2015–16 (RE)

Year	2011–12	2012–13	2013–14	2014–15	2015–16 RE
Actual vs budget	-1.0%	2.9%	-1.9%	-6.5%	-8.6%

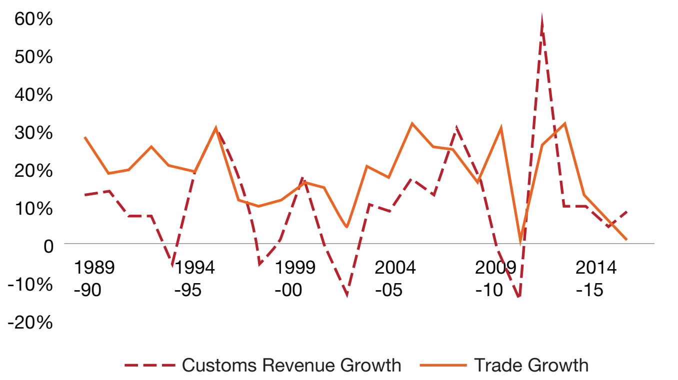
Although projections for a majority of the PIT heads seem to be relatively realistic (more than 90%), one head, namely 'surcharge', merits further consideration. The Government of India, in its budget for FY 2016–17, increased the surcharge from 12% to 15% on persons other than companies, firms and cooperative societies having an annual income above 1 crore INR. The government has increased its budgetary estimate under this head to 7,650 crore INR from 7,500 crore INR in FY2015–16 (RE), amounting to a 2% percentage increase only. This seems an underestimation unless there are policy changes proposed outside the budget document. Given that the surcharge rate has been increased by 25% (i.e. 12% to 15%), the collections under the surcharge can go down only when income tax collections from individuals earning more than 1 crore INR are expected to decline significantly, which is not very likely. Hence, projections for collections under surcharge may turn out to be underestimated.

Customs duty (14.1% share)

Customs duty is levied by the central government on goods imported into, and exported from, India. Hence, the collection is expected to be linked to trends in India's trade with the world. The rate of customs duty applicable to a product imported or exported depends on its classification under the Customs Tariff Act, 1975. Customs duty is levied on the transaction value of the imported or exported goods.

The customs duty applicable to any product is composed of a number of components—that is, (i) basic customs duty (BCD), (ii) additional customs duty in lieu of excise duty, (iii) education cess at 2% and secondary and higher education cess at 1%, (iv) an additional duty of customs (ADC)—to countervail state taxes, and VAT of 4% is charged in addition to the above duties on imports, subject to certain exceptions. ADC is calculated on the aggregate of the assessable value of the imported goods, the total customs duties (i.e. BCD and CVD), and the applicable education cess and secondary and higher education cess. In the budget for FY 2016–17, the finance minister has abolished sector-specific duties such as duty on motor spirits and high-speed diesel oil. However, levies/cesses on imported goods that are earmarked for specific purposes—namely education cess and secondary and higher education cess—continue.

Figure 2: Relationship between trade growth and customs revenue growth (1989–2014)



The government has projected an increase of nearly 10% growth in customs duty collections in FY 2016–17 from FY 2015–16 (RE). The projected increase is not significantly different from the long-term average growth rate (11% for nearly three decades); however, the risk from declining trade growth in the recent past remains. Analysis of trade and customs growth since 1989 shows that the two growth rates are highly correlated (Figure 2). Since 2011–12, the annual trade growth rate has been declining. In 2014–15, trade grew only by 0.3%. Hence, there are downward risks in collections from custom duties.

Union excise duties (20% share)

Union excise duty is levied as per the rates specified in the First and Second Schedules of the Central Excise Tariff Act, 1985. In FY 2015–16, the Government of India initiated some steps to strengthen the administration of union excise duty, which included: (i) online central excise registration in two working days, (ii) increase in the time limit for central value added tax (CENVAT) credit on inputs and input services from six months to one year, and a (iii) facility to digitally sign invoices and maintain electronic records.

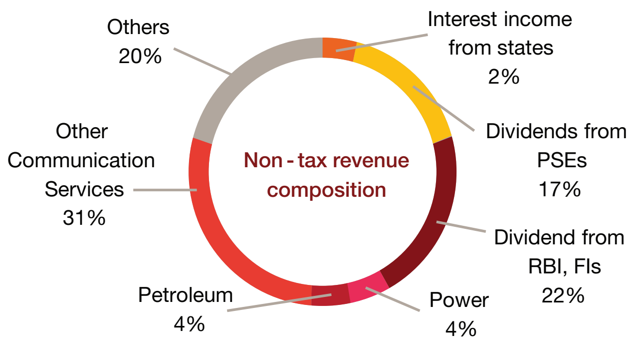
With the fall in global oil prices, the government increased excise duty on petrol and diesel during the preceding financial year (FY 2015–16). Hence, collection under excise on motor spirit and high-speed diesel oil was 72% and 68% more than that budgeted in 2015–16 respectively. Such windfall gains from oil may not be repeated in the coming financial year. The government has therefore brought down growth in the overall excise duty to 12% (from 24% in FY 2015–16 [RE]), which is close to its long-term average growth rate (11.2% between FY 1989–90 to FY 2015–16 [RE]).

Service tax (14.2% share)

The government has projected an increase in service tax collections in FY 2016–17 by 5.3% vis-à-vis FY 2015–16 (RE). In the budget for FY 2016–17, it has introduced the Krishi Kalyan Cess @ 0.5% on all taxable services, the proceeds of which will be exclusively used for financing activities relating to the improvement of agriculture and welfare of farmers. The cess came into force from 1 June 2016. The government had introduced a similar cess for Swachh Bharat initiatives in November 2015 @ 0.5% on all taxable services. It should be mentioned here that while the base as well as the rate is the same for the two cesses, the budgetary estimates for FY 2016–17 are different. The government intends to collect 10,000 crore INR under the Swachh Bharat Cess and 5,000 crore INR under the Krishi Kalyan Cess. Possible explanations for the difference can be: (i) credit of Krishi Kalyan Cess paid on the input side will be available as credit for payment of the cess on the output side. On the other hand, the Swachh Bharat Cess is a cost and non-creditable, and (ii) while the Swachh Bharat Cess will be levied during the entire financial year, the Krishi Kalyan Cess will be levied only post 1 June 2016. Hence, the projected collections appear to be realistic.

Non-tax revenue

Figure 3: NTR composition, 2016–17

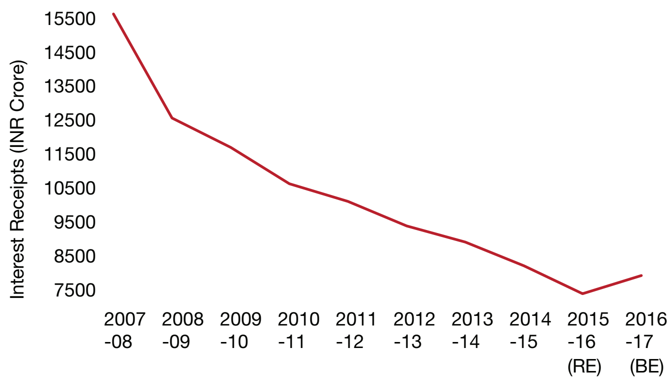


Non-tax revenue (NTR) constitutes 16% of the central government's total receipts (FY 2016–17 [BE]). Major components of NTR include dividends from public sector enterprises (PSEs) and other investments (17%), dividends from the Reserve Bank of India (RBI) and other financial institutions (22%), revenue from the power sector (5%), revenue from the petroleum sector (4%), revenue from other communication services (31%) and others (20%) (Figure 3).

Interest receipts from states

The government has budgeted for a 6% increase in interest receipts on the central government's loans to states in FY 2016–17 vis-à-vis FY 2015–16 (RE). The expected increase could be seen as a reversal of the declining trend since 2007–08 (Figure 4). However, this can be attributed to under-collections in FY 2015–16 (by 6.3%). Further, the comparison of interest receipts expected in FY 2016–17 (BE) with FY 2015–16 (BE) shows a decline by 0.2%.

Figure 4: Interest income from states and UTs (crore INR)



Dividends from central PSEs and on other investments, RBI and financial institutions

Dividend income from PSEs and on other investments is projected to increase by 21% in FY 2016–17 vis-à-vis FY 2015–16 (RE). Dividend income from RBI and other financial institutions such as nationalised banks and insurance companies (e.g. Life Insurance Corporation of India) is, on the other hand, budgeted to decline by 5% as compared with FY 2015–16 (RE). Given the currently stressed financial situation of financial institutions, it is expected that the dividend income of the government would be adversely affected.

Revenue from power sector, petroleum and other communication services

Revenue from the power sector relates to the fee receipts of the Central Electricity Authority under the Electricity (Supply) Act, 2001. In FY 2015–16, NTR (RE) under this head was 346% of BE. This was primarily due to 10,000 crore INR revenue receipts from the Central Electricity Authority. The government has projected the revenue for FY 2016–17 to grow by 1% since no such windfall receipts are expected in FY 2016–17. The projection of 1% growth in FY 2016–17 appears to be realistic.

Revenue from petroleum includes royalty on various petroleum resources, profits shared with the contractor on the production of petroleum, production-level payment, license fees for exploration and petroleum mining leasing fees. In FY 2015–16, collection under this head as per the RE was 23% lower than budgeted, which can be partially attributed to falling oil prices. The government has, therefore, projected 15% growth in revenue from petroleum for FY 2016–17, with the expectation that crude oil prices will grow in the ensuing financial year.

Revenue from other communication services includes one-time charges on auctioning of spectrum. Apart from this, it includes recurring license fees collected from telecom operators and a one-time entry fee for new operators. The government expects a growth of 73% in FY2016–17 and aims to collect about 98,994 crore INR from this head. This is due to the expected spectrum auction starting from July 2016, and the expected collection of deferred payments of auctions in the past will depend on the success of the auctions.

Expenditure side

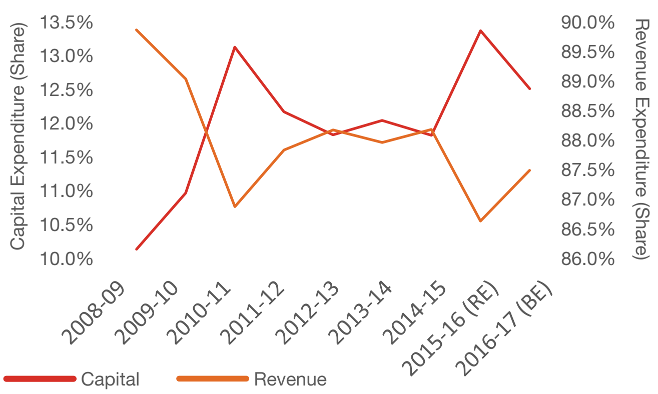
Over the last three decades, the central government expenditure as a percentage of GDP has gone down from 18.7% in FY 1989–90 to 13.13% in FY 2016–17 (Figure 5). This can be attributed to increasing expenditure responsibilities at the state government/local government level (73rd and 74th constitutional amendments). Further, over time, the government has leveraged the strengths of the private sector in delivering services to the public.

Figure 5: Central government expenditure as % of GDP

Total expenditure is expected to increase in FY 2016–17 by 10.8% as compared to the total expenditure of FY 2015–16 (RE). Although actual expenditure in the last three financial years has been lower than the budgetary estimates, it is expected that the government will incur the projected expenditure, given the liabilities arising due to the implementation of the 7th Pay Commission recommendations and One Rank One Pension (OROP) for ex-servicemen.

One of the measures to assess quality of expenditure is the proportion of capital expenditure (which creates assets yielding benefits in the long term) in total expenditure. Capital expenditure as a percentage of total expenditure is expected to decline to 12.5% in FY 2016–17 from 13.3% in FY 2015–16 (RE) (effect of the 7th Central Pay Commission).

Figure 6: Revenue and capital expenditure composition (2008–09 to 2016–17)



Budgeting for the 7th Pay Commission recommendations

Table 5 shows a comparison of pension expenditure as projected by the 7th Pay Commission and provisions made in Budget 2016–17.

Table 5: Pension expenditure 2016–17 (crore INR)

Item	As per the 7th Pay Commission		Budget 2016–17	Deficit
	2016–17 (business as usual [BAU])	2016–17 (required)		
Pension	142,600	176,300	123,368	-52,932

Source: 7th Pay Commission Report (BAU and required estimates), Union Budget Documents for budget estimates of 2016–17

The 7th Pay Commission projects a financial impact of 23.6% with the implementation of its recommendations when compared with the BAU scenario for FY 2016–17. In the budget for FY 2016–17, pension budgetary estimates are nearly 52,932 crore INR lower than the required estimates as per the 7th Pay Commission. One possible explanation could be the expected implementation of the 7th Pay Commission recommendations only in the second half of the financial year. Since government budgeting is on cash basis, the actual pension expenditure would then be lower than the 7th Pay Commission estimates in FY 2016–17. On the other hand, it is also important to mention here that on a yearly basis, there has been under-budgeting of pension expenditure (Table 6). Hence, the possibility of under-budgeting in FY 2016–17 even after taking into account the late implementation of the 7th Pay Commission recommendation cannot be completely ruled out.

Table 6: Pension expenditure vis- à-vis budget, 2011–12 to 2015–16 (crore INR)

Item	2011–12	2012–13	2013–14	2014–15	2015–16
Pension-actual	61,166	69,479	74,896	93,611	95,731
Pension-budget	54,521	63,183	70,726	81,982	88,521
Under-budgeting	12.2%	10.0%	5.9%	14.2%	8.1%

On the salary side, the 7th Pay Commission has projected an impact of about 68,400 crore INR on salaries from BAU estimates for FY 2016–17. The government budget documents do not separately provide salary estimates—the provisions are embedded under various heads. Hence, it may not be possible to ascertain whether the Government of India has made adequate provision in the budget estimated for implementing the 7th Pay Commission recommendations.

While the increase in annual expenditure reflects the government's commitment to enhance efforts for overall development, the compositional change also provides insights into the government's priorities.

Analysis of the compositional change in the total expenditure of the central government in FY 2016–17 reveals that the share of infrastructure sectors such as railways, roads, urban development and power in total budgetary expenditure estimates has gone up, which will boost the economic growth of the country. On the other hand, there is a decline in the share of critical sectors such as school education, water resources, and women and child development in the total budgetary expenditure estimates for FY 2016–17, which is debatable.

Table 7: Compositional change in total central government expenditure

Department	Share in 2016–17 (BE)	Change in 2016–17 vis-à-vis 2015–16 (RE)
Decreasing		
Financial services	1.62%	-0.80%
Fertilisers	3.54%	-0.57%
Interest payments and transfers to states	31.25%	-0.22%
School education and literacy	2.19%	-0.16%
Water resources, river development and Ganga rejuvenation	0.31%	-0.08%
Women and child development	0.88%	-0.08%
Social justice and empowerment	0.33%	-0.003%
Increasing		
Agriculture, cooperation and farmers' welfare	1.82%	0.933%
Defence (civil estimates)	5.99%	0.75%
Railways	2.27%	0.483%
Road transport and highways	2.92%	0.287%
New and renewable energy	0.25%	0.24%
Urban development	1.22%	0.213%
Power	0.62%	0.171%
Housing and urban poverty alleviation	0.27%	0.163%
Health and family welfare	1.86%	0.039%
Defence services	11.25%	0.038%
Higher education	1.45%	0.035%
Skill development and entrepreneurship	0.09%	0.033%
Industrial policy and promotion	0.15%	0.017%
Science and technology	0.23%	0.012%
Rural development	4.35%	0.000%

However, in some cases, an increase in budget may not fully reflect an increase in allocations to the sector. For example, **Table 7** shows that the share of the agricultural sector has gone up by nearly 1 percentage point in FY 2016–17, but a closer look at the budget documents shows that the increase is more due to the transfer of the Pradhan Mantri Fasal Bima Yojana scheme from the Department of Financial Services to the Department of Agriculture, Cooperation and Farmers Welfare. Therefore, the share of the Department of Financial Services in the central government's total expenditure has reduced by 0.8%, while the share of the Department of Agriculture, Cooperation and Farmers Welfare has gone up by 0.93%.

Conclusion

The importance of the central government budget in India as a policy document reflecting the government's plan for where scarce resources will be allocated and how these will be financed is quite high. The government has shown commitment towards fiscal discipline in the ensuing financial year. In the last five years, actual revenues and expenditure have been lower than BE, except for FY 2015–16 (RE). On the revenue side, the budgetary estimates for FY 2016–17 appear to be broadly realistic, notwithstanding minor anomalies. On the expenditure side, there is a projected decline in the share of the capital expenditure in FY 2016–17. The budgetary estimates for pension in FY 2016–17 also appear to be lower than those estimated by the 7th Pay Commission.

Overall, BE look quite realistic, with minor anomalies that could possibly cancel each other out in the actual execution process.

Synopsis of ‘State Finances: A Study of Budgets of 2015-16’

Introduction

RBI publishes an annual report, ‘**State Finances: A Study of Budgets**’, which analyses the fiscal position of all Indian state governments and selected UTs[1] on the basis of disaggregated state-wise fiscal data. The theme of the report for the year 2015–16 was ‘Quality of sub-national public expenditure’, wherein the importance of the qualitative aspects of the expenditure incurred by state governments has been highlighted. This article summarises key observations relating to the consolidated fiscal position of all the 29 Indian sates and 2 UTs (NCT Delhi and Puducherry) mainly for FY 2013–14 and 2014–15 (RE).

Movements in key fiscal parameters

The consolidated fiscal situation of states weakened in 2013–14, which continued to further deteriorate in 2014–15 (RE). However, most states have budgeted for reverting to the path of fiscal consolidation in 2015–16 (BE). Movements in key fiscal parameters of states during 2013–14 to 2014–15 are presented below and in Table 1.

1. States recorded a revenue deficit (RD) of 0.1% in 2013–14 after three years of surplus, owing to a non-commensurate increase in revenue receipts vis-à-vis revenue expenditure due to subdued economic activity. Further, as per 2014–15 (RE), though RD as a percentage of GDP remained the same as in 2013–14, the percentage increase in both revenue expenditure and receipts has been higher than that of 2013–14.

2. The gross fiscal deficit (GFD) and primary deficit (PD) proportions to GDP increased from 2.2 % to 2.9% and from 0.7% to 1.4%, during 2013–14 to 2014–15 (RE) respectively. This was mainly due to a significant increase of 50.5% in states’ capital outlay in 2014–15.

3. The consolidated tax revenue of states improved by 14.8% during 2014–15 (RE). State’s own tax revenue (SOTR) showed an improvement of 14.7% based on enhancement of land revenue (by 14.7%), stamps and registration fees (15.1%) and sales tax VAT (by 15%). The share in central taxes also improved by 15.1% in 2014–15 (RE) over 2013–14.

4. Non-tax revenue of states improved by 84% during 2014–15 (RE). SOTR improved by 21.5%, mainly based on the increase in income from general services by 74.8% (including a 49.8% increase in income from lotteries), from social services by 14.1% and from economic services by 22.6%. However, there was a decline in interest receipts by 10.6% and dividend and profits by 16.2%, which indicates (particularly dividends and profit) the adverse situation of the state level public enterprises (SLPEs).

5. There was a **substantial increase in the grants from the Centre** (by 124.2%) in 2014–15 (RE) over 2013–14 as a result of the decision by the Union Government to route funds which were earlier going directly to state-level implementing agencies through the Consolidated Fund of the States from 2014–15.

6. However, in 2015–16, despite an increase in the share of tax devolution from 32% to 42% of the divisible pool based on the recommendations of the 14th Finance Commission, the central transfers-GDP ratio is budgeted to decline due to the sharp reduction in grants-in-aid. This could be an outcome of the discontinuation of many centrally sponsored schemes (CSS) schemes in Union Budget 2015–16, resulting in a decline of funds under the state plan scheme.

7. Revenue expenditure increased by 32.2% during 2014–15 based on a 40.7% increase in the development revenue expenditure and 18.2% increase in non-development revenue expenditure (NDRE). The **increase in development expenditure has been higher than that in NDRE in 2014–15.**

8. Development revenue expenditure increased on account of higher expenditure on key social and economic services such as education, sports, art and culture, medical and public health, water supply and sanitation, housing, urban development, social security and welfare, nutrition, agriculture and allied activities, rural development, irrigation and flood control, energy, industry and minerals, and transport (mainly roads and bridges). On the other hand, NDRE, which is mainly composed of committed expenditure, increased due to an increase in interest payments (by 27.1%), administrative services (by 14.4%) and pensions (by 14.2%).

[3] The report covers fiscal analysis of two UTs with legislature, namely the National Capital Territory of Delhi (NCT Delhi) and Puducherry.

9. Capital outlay of states as a percentage of GDP increased from 2% in 2013–14 to 2.7% in 2014–15. This was due to an increase in capital outlay on several social and economic services, including education, sports, art and culture, medical and public health, water supply and sanitation, housing, urban development, agriculture and allied activities, rural development, irrigation and flood control, and energy and transport (mainly roads and bridges). The **increase in capital outlay is spread across a wide range of key social and economic services which are important for the growth of states and where revenue expenditure has also increased.** However, the significant increase in revenue expenditure and capital outlay by state governments can be due to the routing of central government funds which were earlier going directly to state-level implementing agencies through the Consolidated Fund of the States from 2014–15.

10. Loans and advances given by state governments increased by 5.5% during 2014–15. Further, 97% of these loans and advances were given for development purposes, where the increase was significant for social and economic services like water supply and sanitation, housing, cooperation, irrigation and power.

11. The consolidated debt (net) raised by state governments increased by 33.3% in 2014–15 (RE) as compared to the previous fiscal year, of which market borrowing increased by 40.5%, while other debts increased by 19.6%.

12. The outstanding liabilities of state governments increased by 12.7% in 2014–15 and as a percentage of GDP, they increased from 21.9% in 2013–14 to 22.3% in 2014–15. However, the consolidated debt–GDP ratio remained below the target recommended by the 13th Finance Commission for the states. Outstanding liabilities are likely to increase on account of the phased takeover of bonds issued by power distribution companies (DISCOMs) under the financial restructuring plan (FRP).

Table 1: Consolidated fiscal position of state governments

Fiscal parameter	Values in billion INR			Per annum growth (%)	
	2013–14	2014–15 (RE)	2015–16 (BE)	2014–15 (RE)	2015–16 (BE)
RD	105.6	183.4	-537.2		
RD/GDP	0.1%	0.1%	-0.4%		
GFD	2,478.5	3,654.6	3,333.3		
GFD/GDP	2.2%	2.9%	2.4%		
Aggregate Receipts (I+II)	**16,262.9**	**21,490.7**	**23,415.4**	**32%**	**9%**
I. Revenue receipts (a+b)	13,691.9	18,058.3	20,118.9	32%	11%
a. Tax revenue (i+ii)	10,306.9	11,830.9	14,177.3	15%	20%
i. Own tax revenue	7,124.2	8,168.7	9,322.1	15%	14%
ii. Share in central taxes	3,182.7	3,662.2	4,855.2	15%	33%
b. Non-tax revenue (i+ii)	3,385.0	6,227.4	5,941.60	84%	-5%
i. States' own non-tax revenue	1,325.5	1,609.9	1,868.8	21%	16%
ii. Grants from the Centre	2,059.55	4,617.5	4,072.8	124%	-12%
II. Net capital receipts (a+b)	2,571.0	3,432.5	3,296.5	34%	-4%
a. Non-debt capital receipts	72.6	102.1	59.8	41%	-41%
b. Debt receipts	2,498.5	3,330.4	3,236.7	33%	-3%
Aggregate expenditure (I+II)	**16,243.0**	**21,814.9**	**23,512.0**	**34%**	**8%**
I. Revenue expenditure, of which:	13,797.50	18,241.60	19,581.70	32%	7%
Development expenditure	8,455.30	11,897.00	12,438.70	41%	5%
Non-development expenditure, of which:	4,909.20	5,804.40	6,603.90	18%	14%
Administrative services	1,073.0	1,364.1	1,548.4	27%	14%
Pensions	1,630.9	1,866.2	2,159.7	14%	16%
Interest payments	1,689.0	1,928.6	2,191.5	14%	14%
II. Capital expenditure, of which:	2,445.40	3,573.30	3,930.30	46%	10%
Capital outlay	2,205.50	3,320.10	3,679.20	51%	11%
Total outstanding liabilities, of which:	**24,712.6**	**27,853.4**	**31,043.8**	**13%**	**11%**
Total internal debt	16,370.7	18,903.4	21,666	15%	15%
Loans and advances from the Centre	1,458.1	1,576.1	1,720.9	8%	9%
Debt/GDP	**21.9%**	**22.3%**	**22%**		

Source: State Finances: A Study of Budgets of 2015-16, RBI

Key takeaway

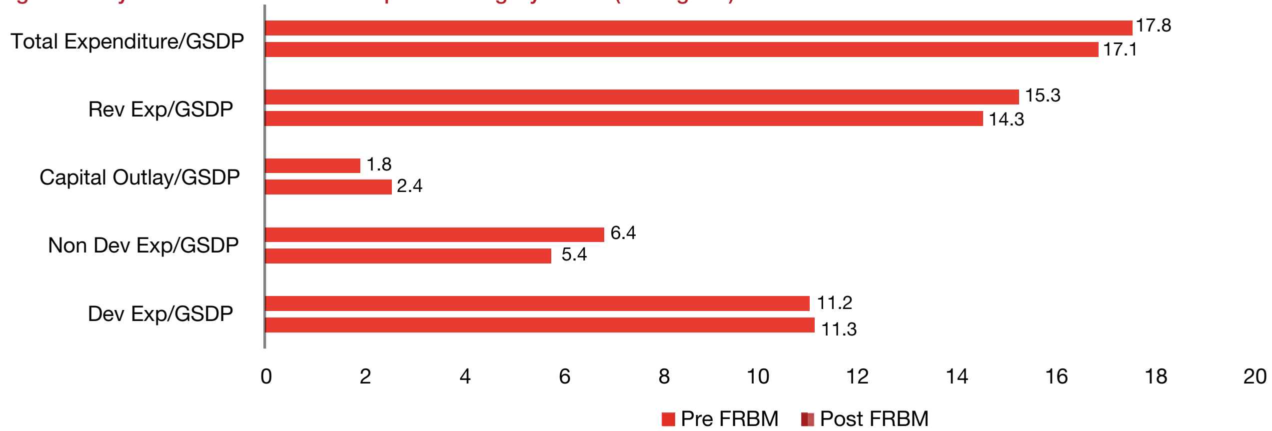
State finances displayed some positive trends during 2014–15, including higher growth of development expenditure in comparison to non-development expenditure, increase in capital outlay in key economic and social sectors, and impressive growth in the own tax and non-tax revenue. Further, there has been a significant increase in revenue expenditure and capital outlay by state governments. One of the reasons for this could be the routing of central government funds which were earlier going directly to the state-level implementing agencies through the Consolidated Fund of the States from 2014–15.

With respect to deficit, though fiscal deficit as a percentage of GDP increased from 2.2% to 2.9% during 2013–14 to 2014–15 (RE), it remained within the general Fiscal Responsibility and Budget Management (FRBM) Act target of 3%. However, revenue deficit as a percentage of fiscal deficit deteriorated from -14% (indicating revenue surplus) in 2011–12 to 4% in 2013–14 and 5% in 2014–15 (RE), which reflects that the share of revenue deficit in fiscal deficit has increased. Controlling revenue deficit may be difficult for the state governments in light of the likely spillover of the implementation of the recommendations of 7th Central Pay Commission.

Impact of FRBM on states' finances

State-level fiscal consolidation in India was initiated through the enactment of FRBM legislations at different points of time for different states. The report analyses impact of FRBM legislations on five broad fiscal indicators: total expenditure, revenue expenditure, capital outlay, and developmental and non-developmental expenditure, which were normalised in terms of gross state domestic product (GSDP). Briefly, 13 out of the 17 non-special category states have been successful in reducing the proportion of their total expenditure to GSDP after implementation of FRBM; 12 states (including all in Group 'A'), which consists of five states with the highest per capita income (PCI)[4] have been able to curtail their revenue expenditure-GSDP ratio in the post-FRBM period; 13 states, including all those in Group 'A' and six in Group 'C', have improved their capital outlay-GSDP ratios. According to the RBI report (2016–17), 'Overall, the quality of expenditure of most Indian states has modestly improved following the enactment of the FRBM Act. Thus, rule-based frameworks have imparted greater responsibility to states on their fiscal positions by enabling them to benchmark themselves vis-à-vis their peers.'

Figure 1: Key fiscal indicators of non-special category states (average %)



Further, with the 14th Finance Commission's recommendation of higher tax devolution from the Centre to the states from 2015–16 onwards, the states will have greater autonomy in prioritising their expenditure on social and physical infrastructure through untied funds. In order to garner additional fiscal space, states need to redouble their efforts in revenue mobilisation along with prioritising expenditure on physical and social expenditure while economising on non-essential heads.

Key takeaway

The FRBM Act has enabled states to take greater responsibility and appropriate disciplinary action on their fiscal position. Several states have been successful in reducing their total expenditure to GSDP and revenue expenditure to GSDP ratio and in improving capital outlay-GSDP ratios following the enactment of FRBM.

[4] Group 'A' represents the top five states in terms of their real per capita incomes (in 2013–14) viz. Goa, Maharashtra, Haryana, Gujarat and Tamil Nadu, while Group 'B' comprises the middle-income states, viz. Kerala, Punjab, Karnataka, Andhra Pradesh and West Bengal, and Group 'C' includes Rajasthan, Jharkhand, Chhattisgarh, Madhya Pradesh, Odisha, Uttar Pradesh and Bihar.

Issues and perspectives

The report has recognised some key issues and challenges that need to be addressed for improving the quality of state finances from a medium-term perspective. A brief analysis of these issues and the areas that require improvement are presented below.

1. Performance of SLPEs

There are 849[5] operational SLPEs in India with a workforce of 1.8 million and primarily operational in manufacturing, finance, power, infrastructure, agriculture and allied services. However, on an average, around 30% of total SLPEs are estimated to be incurring losses. This has adverse fiscal consequences since loss-making SLPEs depend on budgetary support, thereby adversely impacting the state finances. Several factors have resulted in the dismal performance of SLPEs, including inadequate infrastructure, outdated technologies, inadequate maintenance, excess manpower, lack of planning, lack of customer orientation, inadequate quality control check, shortage of working capital, liquidity constraints and higher operational costs in addition to external factors like market conditions and policy changes.

In order to improve the performance of SLPEs, the report recommends developing public enterprise reforms as per the state-specific requirements. The report has recommended the following possible initiatives:

- **Disinvest or transfer ownership to private entities** by providing a company's workforce with an ownership interest in the company through an employee stock ownership plan (ESOP).
- **Restructure SLPEs** by setting up restructuring boards (as done by the Government of Kerala) which will undertake performance monitoring, restructuring, revival package implementation and development of industry information systems for the public sector enterprises. The board can also be involved in the planning and implementation of comprehensive restructuring interventions in sick enterprises on a case-by-case basis through capital upgradation, technology modernisation, reduction of debt burden, broad basing the sources of finance and organisational changes.
- **Grant autonomy to enterprises**, based on commercial considerations and without political interference.
- **Improve professional expertise** in accounting and finance departments.
- **Invest in research and development** for enhancing product quality and understanding consumer preferences need a thorough market survey.
- **Periodically review SLPEs**, through which expansion/ modernisation can be prioritised based on thrust areas and market conditions (as is being done in Tamil Nadu).

[5] GoI report, 2012

Key takeaway

The loss-making and debt-burdened SLPEs are having an adverse effect on state finances as they depend on states' budgetary support. There is an urgent need to improve the performance of these SLPEs by disinvestment or transfer of ownership to private entities, restructuring, granting autonomy or improving management and R&D of these enterprises.

2. State power utilities

The power sector, consisting of generation, transmission and distribution, is a key infrastructural input for harnessing a state's development potential. Distribution and retail supply, however, remain the weakest link in the entire value chain. State electricity boards (SEBs) are the dominant players in the power sector, being responsible for generation, transmission and distribution. Deteriorating financial health and mounting losses and debt necessitated reforms in the power sector. The enactment of the Electricity Act, 2003, mandated the unbundling of SEBs into separate and independent generation, transmission and distribution companies (DISCOMs). Reform initiatives were extended through the Accelerated Power Development and Reforms Programme (APDRP) in 2002–03, Restructured-APDRP in 2008 and financial restructuring plan (FRP) in 2012. FRP was targeted at all participating state-owned DISCOMs, which had accumulated heavy losses and faced difficulty in financing operational losses.

The key reasons for the deteriorating finance of distribution entities are (i) delay and non-payment of subsidies by the state government, (ii) underpricing with selling price set significantly lower than the procurement price for electricity, (iii) delay in release of financial results resulting in inadequate assessment of their financial viability by potential lenders, (iv) lower demand for energy by DISCOMs (due to their fragile financial health) affecting power purchase agreements (PPAs) with power-generating entities, and (v) inadequate evaluation of credit risk by banks and financial institutions.

A recent initiative taken by the central government through the Ujwal DISCOM Assurance Yojana (UDAY) launched in November 2015 aims at improving the financial viability and operational efficiency of state-owned DISCOMs. Under the scheme, participating states will take over 75% of DISCOM debt as on 30 September 2015 over two years: 50% in 2015–16 and 25% in 2016–17. The remaining DISCOM debt will be converted either by banks or financial institutions into loans or bonds, or can be fully or partly issued by the DISCOM as state-guaranteed DISCOM bonds with an interest rate not more than the bank's base rate plus 0.1 %. The scheme also empowers DISCOMs with the opportunity to break even in the next two to three years through initiatives like (i) improvement of operational efficiencies, (ii) reduction in cost of power, (iii) reduction in interest burden and (iv) enforcement of financial discipline through alignment with state finances. There are, however, some areas of concern regarding the impact of UDAY on state finances over the medium term.

Key takeaway

To reduce the debt and losses of power DISCOMs, the central government has launched UDAY, which aims to improve the financial viability and operational efficiency of state-owned DISCOMs. However, as the states are required to take over 75% of DISCOM debts under the scheme, it may result in reduction of fiscal space and increase in interest burden for the state governments in the medium term.

3. Centrally sponsored schemes

The central government provides centrally sponsored schemes (CSS) to states to encourage and motivate state governments to attain national goals and objectives. However, states have highlighted the lack of flexibility in these schemes. As recommended by the 14th Finance Commission, central assistance to states has now been subsumed under major CSS in view of the larger devolution of the divisible pool of tax revenue (42%) to states. Though many CSS on state subjects are to be delinked from central support, those representing national priorities, especially poverty alleviation, will continue.

A sub-group of Chief Ministers on Rationalisation of Centrally Sponsored Schemes has recommended reduction of the number of CSS from 72 to 27. As per Union Budget 2016–17, (1) the existing funding pattern of 6 schemes defined as 'core of the core' has been retained; (2) the funding pattern of 18 schemes defined as 'core' schemes will be 60:40 between the Centre and states (90:10 for northeastern and three Himalayan states); and (3) three optional schemes with a funding pattern of 50:50 between the Centre and states (80:20 for northeastern and three Himalayan states).[6]

Further, it has been suggested in the report that the implementation of CSS needs to be improved by focussing on better public service delivery, better quality management, innovative IT usage and greater autonomy to states in strategy planning and allocation of funds. Scheme guidelines need to be adapted to the local situation and coordination with related departments and agencies needs to be improved.

Key takeaway

Due to their lack of flexibility, CSS have been reduced from 72 to 27 in Union Budget 2016–17. Further, with the 14th Finance Commission recommending higher tax devolution from the Centre to the states from 2015–16, the states will have greater autonomy in prioritising their expenditure on social and physical infrastructure through untied funds.

4. State finance commissions (SFCs)

The Constitution of India provides for the creation of SFCs on the lines of the Central Finance Commission (CFC) every five years for the devolution of resources from the state to local governments, (panchayati raj institutions [PRIs] and urban local bodies [ULBs]). SFCs also make recommendations required to improve the financial position of the local governments. However, SFCs have been faced with several issues such as delay in their constitution, divergence in the submission of SFC reports and 'action taken' reports across states, lack of transparency in verifying data of local governments, and constitution of SFC members from generally one discipline which undermines the status and authority of the SFC. Further, it has also been pointed out that while the financial recommendations of SFCs are addressed, their recommendations on systematic improvements are ignored.

To strengthen the performance of the SFCs, the following initiatives can be undertaken:

- SFCs should be appointed at the expiration of every fifth year.
- Action taken reports should be presented by the state governments in the state legislature in a time-bound manner.
- SFCs should be supported in efficiently performing their functions by setting up of an independent national agency for providing a common platform for the exchange of information between SFCs; simpler account and data formats should be designed; and studies on standards of essential civic services to help future SFCs to assess the performance of local bodies should be supported.
- Availability of data on local body finances should be improved. For this, the 14th Finance Commission has recommended performance grants to address the availability of reliable data on local bodies' receipt and expenditure through audited accounts and improvement in own resources. The 14th Finance Commission has also suggested ULBs to measure and publish service-level benchmarks for basic services.

Key takeaway

Appointment of SFCs every fifth year, timely submission of action taken reports, setting up of an independent platform for exchange of information between SFCs and improvement in the availability of data on local body finances can strengthen the performance of SFCs.

[6] Source: PART-III, Plan Outlay, Expenditure Budget Vol. I, 2016-2017

Conclusion

The recent trends in the fiscal indicators of states have presented some positive developments, including higher growth of development expenditure as compared to non-development expenditure, increase in capital outlay in key economic and social sectors, and double digit growth in the own tax and non-tax revenue of states. Increase in revenue receipts of states can be expected to continue with prospects of better economic growth outlook. FRBM legislations seem to have had a disciplinary effect on the fiscal position of states.

However, the increasing revenue deficit as a percentage of fiscal deficit is an area of concern. Further, managing the huge outstanding debts of states can be a challenge, with the situation likely to deteriorate with states taking over power sector debt. States will also be required to control the rising trend in their committed expenditure-GSDP ratio, which is expected to rise further owing to the spillover effect of the implementation of the 7th Central Pay Commission recommendation on the states.

Going ahead, states can take advantage of the recent momentum in economic growth in the country by converting it into higher revenue receipts by bringing efficiency in revenue collection and administration and simultaneously channelling these receipts into productive economic and social sectors to further boost the economy by creating more jobs and income opportunities.

Round the corner

News bytes

1. 7th Pay Commission: Government 'by and large' accepts recommendations, minimum salary raised to 18,000 INR

Indian Express, New Delhi: 30 June 2016

The Union Cabinet approved recommendations of the 7th Pay Commission on 29 June 2016. The 7th Pay Commission report will be effective from 1 January 2016, and the Cabinet will decide if the arrears for the six months will be paid in one go or in instalments. The recommendation to increase minimum pay from existing 7,000 INR to 18,000 INR per month has also been accepted. Over one crore central government employees, past and present, are expected to benefit from the 7th Pay Commission recommendations.

Source: *http://indianexpress.com/article/business/business-others/7th-pay-commission-cabinet-meeting-latest-updates-today-2882835/*

Impact of the 7th Pay Commission

Blog by Ranen Banerjee, Leader, Public Finance and Economics, PwC India

The Union Cabinet recently cleared the 7th Pay Commission. This is going to have a positive effect on consumption as well as savings and consequently on growth. A part of the payout comes back to the government by way of taxes that will also partially help in meeting the funding requirement.

In the aftermath of recent international developments, that have made the global headwinds stronger, a consumption demand boost owing to higher disposable income in the hands of government employees will provide some further cushion to growth in the economy. However, concerns lie on the quantum of additional outgo of 1 lakh crore INR. The total capital expenditure outlay of government in FY17 is 2.4 lakh crore INR. Thus, the capital expenditure should not come under threat owing to this. The outgo will also possibly be staggered across FY17 and FY18 and impending implementation of GST in FY18 may provide the revenue needed to fund this additional outgo.

2. Direct tax collection jumps 18% to 43,391 crore INR in Apr–May

The Financial Express, New Delhi: 10 June 2016

The Government of India claimed that the net direct tax collections jumped by 18% to 43,391 crore INR during the first two months of the current fiscal year. The indirect tax growth rate for April–May FY17 is 36.7% with additional revenue measures (ARM) and 14% without ARM. Direct tax collection, which includes corporation tax, income tax and wealth tax, is estimated to rise by 12.64% to 8,47,097 crore INR this year from 7,52,021 crore INR in 2015–16.

Source: *http://www.financialexpress.com/article/economy/direct-tax-collection-jumps-18-to-rs-43391-cr-in-apr-may/280577/*

3. India's GDP growth accelerates to 7.9 %

The Hindu, New Delhi: 31 May 2016

India's GDP grew 7.9% in the fourth quarter of 2015–16, thereby increasing overall growth for the entire year to 7.6%. This has helped India in maintaining its position as the fastest-growing major economy, according to the Central Statistics Office (CSO). India's gross value added (GVA) for the year grew by 7.2% in what economists termed a consumption-led recovery.

Source: *http://www.thehindu.com/news/national/indian-economy-grows-at-76-pc-in-fy16-79-pc-in-q4/article8673311.ece*

4. 200% increase in outward remittances

Financial express, Mumbai: 19 April 2016

Indians are now spending more money abroad, with figures released by RBI showing that outward remittances under the Liberalised Remittances Scheme (LRS) have surged by close to 200% in fiscal 2015–16.

According to RBI data, Indian residents have sent 3.81 billion USD out of the country in the first eleven months of FY 2015–16, which is almost 187% more than 1.32 billion USD outward remittances in 2014–15. The full fiscal outflow is expected to cross 4 billion USD, or over 26,000 crore INR.

According to RBI, remittances under the head 'maintenance of close relatives' and 'studies abroad' have risen sharply in the last nine months. Student remittances had touched 1 billion USD in the last eight-nine months. It is estimated that close to three lakh Indian students go abroad every year for studies, with the US remaining the preferred destination.

With a rise in foreign exchange reserves, the government and the central bank has also allowed people to start investing outside for business and other purposes, which has also contributed to the flow of outward remittances. Further, there are many blue collared workers in India who send money home to Nepal and Bangladesh. This also adds to outward remittances.

Source: *http://www.financialexpress.com/article/industry/banking-finance/200-increase-in-outward-remittances/239136/*

5. RBI indicates possible swings in forex reserves

Financial Express Bureau, Mumbai: 14 April 2016

RBI has indicated that the possibility of fluctuations in the country's foreign exchange reserves closer to the time when the foreign currency non-resident (FCNR-B) deposits start maturing from September. The central bank stated that it has adequately covered the swaps related to the FCNR-B scheme by its forward purchases. However, since the forward purchases and the FCNR (B) swaps are not exactly synchronous in terms of maturity bands, it said there is a likelihood of a surge in the reserves followed by a fall of almost the same magnitude. The country's foreign exchange reserves had recently hit a record high of 359.759 billion USD as on 1 April.

RBI has, however, assured that it is actively monitoring the ongoing market developments and is ready to contain any possible associated market volatility in relation to completion of swap transactions as well as the associated changes in rupee liquidity.

Source: http://www.financialexpress.com/article/industry/banking-finance/rbi-indicates-possible-swings-in-forex-reserves/236344/

6. 70,000 crore INR allocated for 7th Pay Commission in Budget 2016

Indian Express, New Delhi: 17 March 2016

Around 70,000 crore INR have been provisioned in the Union Budget 2016–17 for the implementation of the 7th Pay Commission for government employees. While the budget did not provide an explicit overall provision number, the government asserted that the 7th Pay Commission hike has been built in as interim allocation for different ministries. It is expected that implementation of the suggestions made in the pay commission report will cost the government 1.02 lakh crore INR in total.

The government, in January, set up a high-powered panel headed by the Cabinet Secretary P K Sinha to process the recommendations of the 7th Pay Commission, which will have a bearing on the remuneration of 47 lakh central government employees and 52 lakh pensioners.

Source: *http://indianexpress.com/article/business/budget/rs-70000-cr-allocated-for-7th-pay-commission-in-budget-2016/*

Paper releases

1. Finance for micro, small, and medium-sized enterprises in India: Sources and challenges

Working Paper from ADB, July 2016

Finance for micro, small, and medium-sized enterprises (MSMEs) has been a concern for all stakeholders including entrepreneurs, financial institutions, and government organizations. The key objective of the study was to identify various challenges faced by MSMEs in sourcing finance during different stages of their life cycle. This study is a first-of-its-kind attempt to focus on these aspects. The study further explores whether the financial awareness of MSME entrepreneurs is a major limitation in the identification and utilization of sources of finance. Data was collected through personal interviews using a structured questionnaire from a sample of 85 MSMEs. The survey was conducted mainly in the city of Bangalore covering a wide spectrum of sectors like precision tools, weavers, jewellers, food retailers, metal works, textiles, and book shops. The results reinforce the findings of other studies that utilization of formal sources like banks is significantly small compared with informal sources like personal and family wealth. The study found that the main challenges faced in underutilization of formal sources were inadequacy of collateral assets and lack of financial awareness of entrepreneurs. Based on the conclusion that requirement of finance differs with the life-cycle stage of the MSME, recommendations have been proposed for entrepreneurs, financial institutions, and policy makers.

Source: *http://www.adb.org/sites/default/files/publication/188868/adbi-wp581.pdf*

2. Foreign direct investment in India's retail sector and farmers' productivity: Few issues

IIM Bangalore Research Paper, June 2016

Productivity is generally defined as the amount of output realised for a given level of inputs. The neo-classical growth theory considers productivity as a function of technology and capital accumulation. In this paper, author has argued that apart from technology and capital, productivity depends on institutional factors such as property rights, incentives, transaction, and information costs. Foreign direct investment in India's retail sector can bring in the best practices of supply-chain management and reduce transaction and information costs of input and output markets and thereby contributes to farmers' productivity. Author has presented few conceptual issues and qualitative empirics on this topic.

Source: *http://www.iimb.ernet.in/research/sites/default/files/WP%20No.%20366.pdf*

3. The status of financial inclusion, regulation, and education in India

Working Paper from ADB, April 2016

India's financial inclusion agenda has witnessed a paradigm shift over the last decade, away from an emphasis on credit to a more comprehensive approach toward financial services (e.g., opening bank accounts and offering basic financial products, such as insurance). This paper describes the structure of banking and microfinance institutions in India relevant to the developing model of financial inclusion, as well as relevant regulatory structure and modes of delivery. It explains the current state of financial inclusion, as well as regulatory changes necessary to make the new architecture for inclusion viable, including a critique of some of the recommendations of the Mor Committee on Comprehensive Financial Services for Small Businesses and Low-Income Households. The paper then reviews modes of delivery and the regulatory structure being contemplated or recently introduced. It assesses the suitability objective envisaged as critical for inclusion, associated challenge of revamping consumer protection laws, and imperative of improving financial literacy. The paper also discusses the case of micro, small, and medium-sized enterprises in the given context.

Source: *http://www.adb.org/publications/status-financial-inclusion-regulation-and-education-india*

4. Debt dynamics, fiscal deficit, and stability in government borrowing in India: A dynamic panel analysis

Working Paper from ADB, March 2016

This paper examines the fiscal performance of states in India. Despite the initiatives of the Finance Commission of India, fiscal performance has been deteriorating and increasingly diverging across Indian states. Given that the state governments are endowed with expenditure autonomy, this paper investigates whether the composition of expenditure of the subnational governments has an impact on the degree of indebtedness. A panel analysis for the 17 non-special category states over 1980–2013 indicates that apart from the budget structure, the state-specific factors affecting fiscal performance plays an important role in government borrowing. Curiously enough, government borrowing is more responsive to revenue expenditure than capital outlay and has more growth-augmenting effect through revenue expenditure.

Source: *http://www.adb.org/publications/debt-dynamics-fiscal-deficit-and-stability-government-borrowing-india-dynamic-panel*

5. Capital flows and central banking: The Indian experience

Working Paper from the World Bank Group, February 2016

Because of the steady liberalisation of the capital account since the early 1990s and increased financial integration of the Indian economy, capital flows to India have moved in tandem with broad global trends. This paper looks at the extent to which India's monetary policy has been affected by the ebbs and flows of the capital it receives. For ease of narration, the paper divides the post-liberalisation period since the early 1990s into three phases-early 1990s to early 2000s, a period of increasing but still modest capital flows; early 2000s to 2007-08, a period of capital flow surge when inflows increased rapidly; and a period of sudden stops and volatility, starting in 2008-09, when capital flows reversed in the post-Lehman Brothers collapse, and again during the tapering tantrum of 2013. The paper shows that although ordinarily domestic policy imperatives, such as price stability and growth, have taken precedence over issues related to exchange rate or capital flows in policy rate setting, some accommodation in money supply is evident during the surge and stop episodes. The broad policy mix to handle large increases or reversals of capital flows has included reserve management, liquidity management, and capital flow measures.

Source: *https://openknowledge.worldbank.org/handle/10986/23895*

Potpourri

The recent RBI report on state finances presents the performance of all Indian states and selected union territories on key public finance management (PFM) indicators. We have selected five key PFM indicators (gross fiscal deficit/GSDP, debt/GSDP, social expenditure/total expenditure, capital outlay/GSDP and own tax revenue/GSDP ratio) and have evaluated the relative performance of states on these indicators. We have grouped states into four key categories as per their performance and have depicted these on a map of India using specific colour codes. The four performance categories are (1) first quadrant (top 25% performers), (2) second quadrant (states ranked 8th to 14th for performance on concerned indicator), (3) third quadrant (states ranked 15th to 21st) and (4) fourth quadrant (bottom 25% performers).[7]

Figure 1: Ranking of states on the basis of gross fiscal deficit/GSDP ratio (using actual estimates for FY 2013–14)

S.NO	State	GFD/GSDP 2013-14 Actuals data (+) means deficit & (-) means surplus
1	Manipur	- 1.89
2	Tripura	- 0.19
3	Sikkim	0.40
4	Jharkhand	1.28
5	Odisha	1.70
6	Maharashtra	1.72
7	Meghalaya	1.73
8	Andhra Pradesh	2.11
9	Haryana	2.14
10	Uttarakhand	2.16
11	Madhya Pradesh	2.28
12	Assam	2.37
13	Gujarat	2.40
14	Tamil Nadu	2.41
15	Bihar	2.43
16	Nagaland	2.59
17	Chhattisgarh	2.72
18	Uttar Pradesh	2.75
19	Goa	2.77
20	Punjab	2.77
21	Karnataka	2.78
22	Rajasthan	2.94
23	West Bengal	3.59
24	Kerala	4.27
25	Himachal Pradesh	4.85
26	Jammu and Kashmir	5.20
27	Mizoram	7.28
28	Arunachal Pradesh	11.90
	All States	2.20

State with lowest fiscal deficit

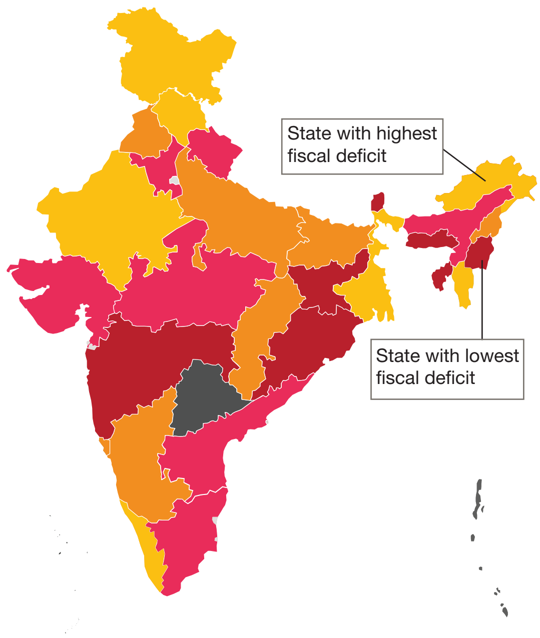
First quadrant - Top 25% performers

Second quadrant states on fiscal deficit indicator

Third quadrant states on fiscal deficit indicator

Fourth quadrant states on fiscal deficit indicator

State with highest fiscal deficit



- Top 25% states on fiscal deficit performance
- Second quadrant states on fiscal deficit performance
- Third quadrant states on fiscal deficit performance
- Fourth qudrant (bottom 25%) states on fiscal deficit performance

[7] As Telangana was formed in June 2014 and we are using actual estimates for FY 2013–2014, it has not been covered in the ranking of states presented in this section.

Figure 2: Ranking of states on the basis of debt/GSDP ratio (using actual estimates for 2014)

S.NO	State	2014 (actuals) Debt/GSDP
1	Chhattisgarh	14.0
2	Odisha	18.5
3	Assam	19.4
4	Haryana	20.5
5	Maharashtra	20.5
6	Tamil Nadu	21.0
7	Jharkhand	21.9
8	Madhya Pradesh	22.2
9	Karnataka	22.6
10	Andhra Pradesh	22.9
11	Gujarat	24.6
12	Uttarakhand	24.7
13	Rajasthan	24.8
14	Bihar	25.8
15	Sikkim	27.0
16	Goa	27.2
17	Meghalaya	30.0
18	Uttar Pradesh	30.9
19	Kerala	31.7
20	Punjab	32.2
21	Tripura	32.6
22	Arunachal Pradesh	34.8
23	West Bengal	36.7
24	Himachal Pradesh	41.0
25	Nagaland	47.1
26	Manipur	49.5
27	Jammu and Kashmir	51.2
28	Mizoram	60.4
	All States	21.9

State with lowest debt

Top 25% states on debt indicator

Second quadrant states on debt indicator

Third quadrant states on debt indicator

Fourth quadrant (botton 25%) states on debt indicator

State with highest debt

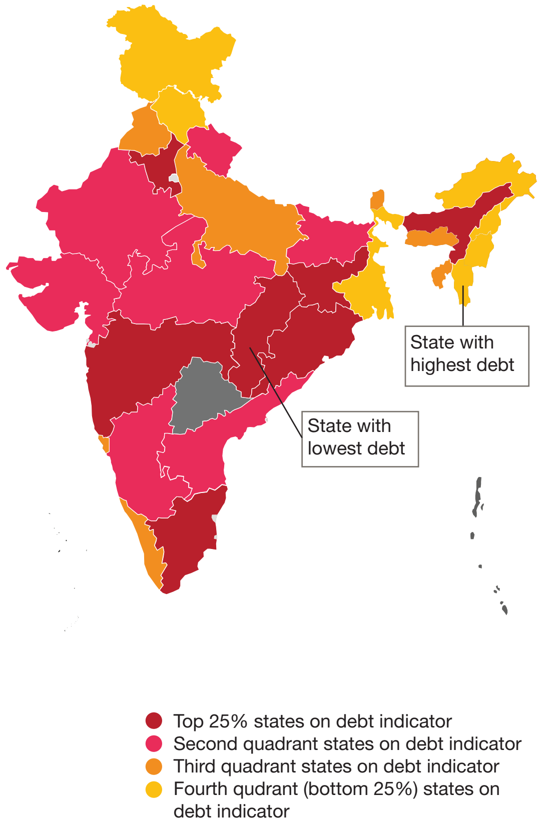


Figure 3: Ranking of states on the basis of social expenditure/total expenditure ratio (using actual estimates for FY 2013–14)

S.NO	State	2013-2014 (actuals)
		SE/T E
1	Chhattisgarh	53.4
2	Rajasthan	44.5
3	Odisha	44.2
4	Uttarakhand	43.6
5	Bihar	43.4
6	West Bengal	42.0
7	Maharashtra	41.9
8	Tripura	41.6
9	Tamil Nadu	41.1
10	Mizoram	40.8
11	Gujarat	40.0
12	Meghalaya	39.9
13	Madhya Pradesh	39.8
14	Andhra Pradesh	39.3
15	Jharkhand	39.0
16	Assam	39.0
17	Uttar Pradesh	38.1
18	Sikkim	37.8
19	Karnataka	37.6
20	Himachal Pradesh	37.1
21	Haryana	37.0
22	Goa	35.8
23	Kerala	34.5
24	Arunachal Pradesh	32.8
25	Nagaland	29.8
26	Jammu and Kashmir	29.7
27	Manipur	29.4
28	Punjab	27.5
	All States	39.8

State with highest percentage of social expenditure

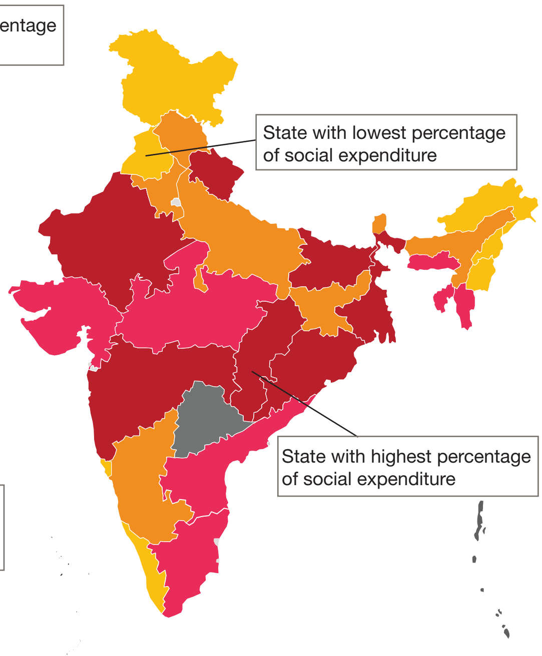
Top 25% states on social expenditure indicator

Second Quadrant states on social expenditure indicator

Third Quadrant states on social expenditure indicator

Fourth Quadrant states on social expenditure

State with lowest percentage of social expenditure



- Top 25% states on social expenditure
- Second quadrant states on social expenditure
- Third quadrant states on social expenditure
- Fourth qudrant (bottom 25%) states on social expenditure

Figure 4: Ranking of states on the basis of capital outlay/GSDP ratio (using actual estimates for FY 2013–14)

S.NO	State	2013-2014 (actuals) CO/GSDP
1	Arunachal Pradesh	12.4
2	Manipur	9.0
3	Sikkim	7.4
4	Nagaland	6.8
5	Tripura	6.1
6	Mizoram	5.8
7	Jammu and Kashmir	5.1
8	Meghalaya	4.9
9	Bihar	4.1
10	Uttar Pradesh	3.8
11	Uttarakhand	3.0
12	Gujarat	3.0
13	Odisha	2.8
14	Karnataka	2.8
15	Jharkhand	2.7
16	Rajasthan	2.6
17	Madhya Pradesh	2.5
18	Chhattisgarh	2.5
19	Himachal Pradesh	2.2
20	Goa	2.1
21	Assam	2.0
22	Tamil Nadu	2.0
23	Andhra Pradesh	1.8
24	Maharashtra	1.3
25	Kerala	1.1
26	West Bengal	1.0
27	Haryana	1.0
28	Punjab	0.7
	All States	1.9

State with highest CO/ GSDP ratio

Top 25% states on capital outlay performance

Second quadrant states on capital outlay performance

Third quadrant states on capital outlay performance

Fourth quadrant (bottom 25%) states

State with lowest CO/ GSDP ratio

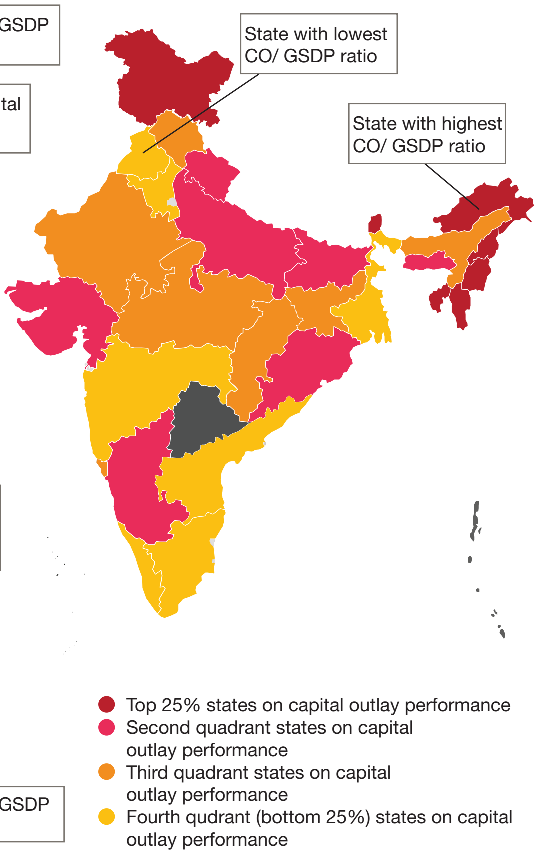


Figure 5: Ranking of states on the basis of own tax revenue/GSDP ratio (using actual estimates for FY 2013–14)

S.NO	State	2013-2014 (actuals)
		Own tax revenue/GSDP
1	Karnataka	10.2
2	Tamil Nadu	8.6
3	Kerala	8.1
4	Uttar Pradesh	7.7
5	Madhya Pradesh	7.7
6	Chhattisgarh	7.7
7	Punjab	7.6
8	Andhra Pradesh	7.5
9	Gujarat	7.4
10	Goa	7.3
11	Jammu and Kashmir	7.2
12	Maharashtra	7.2
13	Haryana	6.6
14	Rajasthan	6.5
15	Himachal Pradesh	6.2
16	Odisha	6.2
17	Uttarakhand	6.0
18	Bihar	5.8
19	Assam	5.6
20	Jharkhand	5.4
21	West Bengal	5.1
22	Meghalaya	4.3
23	Sikkim	4.2
24	Tripura	4.0
25	Manipur	3.3
26	Arunachal Pradesh	3.2
27	Mizoram	2.2
28	Nagaland	1.9
	All States	6.3

State with highest own tax revenue / GSDP

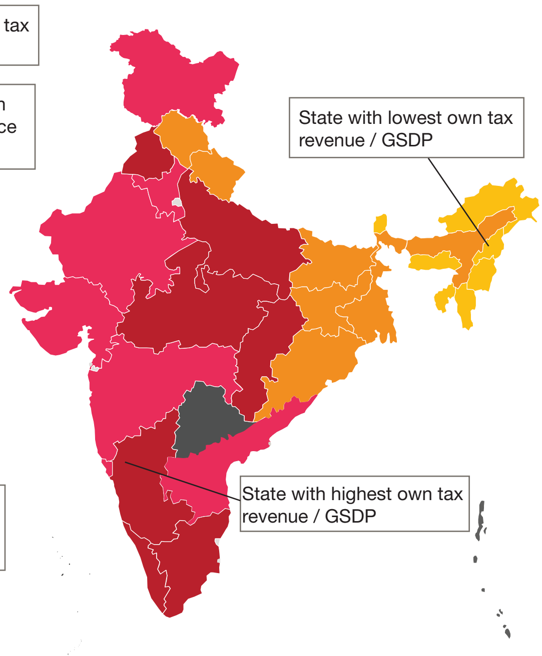
Top 25% states on own tax revenue performance indicator

Second quadrant states on own tax revenue performance indicator

Third quadrant states on own tax revenue performance indicator

Fourth quadrant (botton 25%) states on own tax revenue performance indicator

State with lowest own tax revenue / GSDP



- Top 25% states on own tax revenue performance indicator
- Second quadrant states on own tax revenue performance indicator
- Third quadrant states on own tax revenue performance indicator
- Fourth qudrant (bottom 25%) states on own tax revenue performance indicator

Our work

The SARH Systematic Review (SR) Programme for South Asia

The SARH SR Programme for South Asia aims to provide policymakers in South Asia with a robust assessment of the evidence base to help in policymaking and programme design. The programme involves commissioning **15** research products, mainly systematic reviews (SRs), in areas relevant to the development priorities of South Asia to assess what works and what does not in development programming. The programme also aims to build capacity, preferably embedded in the institutions in South Asia, for producing more systematic reviews and other rigorous evidence products in the region.

The SARH SR programme consortium is led by PwC with the Evidence for Policy and Practice Information and Coordinating Centre (EPPI-Centre) and LIRNEasia as sub-consultants. PwC is the lead management team (LMT) in the project.

As the LMT, PwC has been involved at all levels of the programme, including both managerial as well as technical activities. Our key activities include the following:

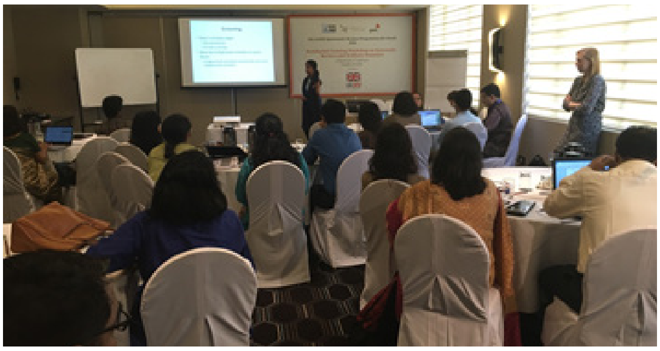
- **Identification of sectors:** Identifying priority development sectors for South Asia by engaging with DFID country advisors
- **Gap map analysis:** Identifying areas where systematic reviews are not available and evidence-based policy recommendations are needed

> 'A systematic review is a high-level overview of primary research on a particular research question that tries to identify, select, synthesise and appraise all high-quality research evidence relevant to that question in order to answer it.'
>
> Cochrane, A. L. (1972). Effectiveness and efficiency: Random reflections on health services. London: Nuffield Provincial Hospitals Trust.

- **PICOS analysis**: Developing the structure and scope of reviews by identifying the relevant populations, interventions, comparison groups, outcomes and study designs
- **Procurement and contracting:** Selecting academic and research institutes through competitive bidding for conducting 15 reviews and evidence summaries as well as contracting with successful bidders
- **Financial management:** Preparing budget forecasts and expenditure reports for the programmes and managing payments of selected teams under the programme
- **Dissemination:** Communicating and supporting uptake of research findings and managing programme communications
- **Monitoring progress:** Coordinating with selected teams to manage reviews and facilitate quality assurance and capacity-building support and ensuring adherence to work plans for selected teams
- **Programme management**: Developing and updating work plans, preparing progress reports, and coordinating with the client in various project aspects

The research themes for the reviews cover a wide range of socioeconomic topics, including nutrition programmes, behaviour change communication, gender-responsive policing, urbanisation, migration, non-state justice, market-led rural development, natural resource revenue management and disaster management approaches.

Residential training workshop on SRs, organised under the programme in Colombo, Sri Lanka



Out of the 10 teams selected under the programmes, five teams are trainee teams that are being trained by our SR experts for conducting systematic reviews and evidence-based research. As a part of their capacity-building activities, we recently concluded a residential training workshop on systematic reviews in Colombo, Sri Lanka.

Another unique feature of this programme is the contextualisation framework, which is being developed by the SR consortium. This framework will be used to analyse findings in the context of the South Asia region as well as specific countries and help draw out policy lessons for specific geographies.

We have also launched our third call for reviews in June, wherein we will be selecting four more teams for conducting SRs and evidence summaries.

Our people

Sambit Rath

Designation: Manager, Public Sector and Governance, GRID

Education:

- MPhil (Policy Studies), Jawaharlal Nehru University, 2004
- MA (Statistics), Utkal University, 1999
- BA (Statistics, Hons), Utkal University, 1997

Age: 38 years

Work experience: About 10 years
Countries worked in: India

Sambit is a Manager with the Public Sector and Governance team of the Government Reforms and Infrastructure Development (GRID) SBU of PwC India. He is a statistician by training and holds an MPhil in Policy Studies from Jawaharlal Nehru University, New Delhi. He has extensive experience in providing advisory services in designing, conducting experimental and non-experimental evaluation studies, setting up monitoring and evaluation systems, and undertaking studies requiring applied micro-econometric and applied statistical modelling.

He has been involved in designing and managing large-scale impact evaluations of various policy experiments like conditional and unconditional cash transfers, skill vouchers, monetisation of social vulnerabilities, cost-benefit analyses, and microfinance lending types.

Sambit has worked with multiple international development agencies like DFID, UNICEF, UNDP, NWO-WOTRO (Netherlands), Micro Credit Summit (MCS) Foundation, and IKEA Foundation. He has been a part of various DFID projects such as Madhya Pradesh Urban Services for the Poor, Odisha Girls Incentive Programme Part-1 and Part-2. For UNDP, he worked with the Government of National Capital Territory of Delhi in combining various social protection interventions into a single cash transfer scheme. Sambit had also worked with UNICEF (and SEWA) on designing a universal unconditional cash transfer scheme in Madhya Pradesh and with UNDP and the Government of Delhi in carrying out a randomised control trial involving cash transfers in place of ration cards. For MCS, he conducted an evaluation of various MFI loan instruments and their effects on progression from poverty.

He recently designed the M&E system and MIS for an IKEA Foundation project spanning seven states in India, which seeks to provide skills training and employment to one million women.

Sambit is currently working on a project that seeks to design and evaluate the combined effects of rural electrification, stable power supply due to feeder separation and training of women in the efficient use of electricity in microenterprises.

His research on the role of MFIs in financial inclusion was published in *Review of Market Integration*, a peer-reviewed journal published by SAGE. His evaluation of a Madhya Pradesh slum upgradation initiative was published in an edited volume. In addition, he has presented papers at national and international conferences.

About us

The Public Sector and Governance (PS&G) practice of the Government Reforms and Infrastructure Development (GRID) SBU of PwC in India has been working closely with clients in the public sector and at all levels of the government as well as key donors such as Department for International Development (DFID), Japan Bank for International Cooperation (JBIC), World Bank and Asian Development Bank (ADB). A large team of full-time dedicated professionals and associates provides services to governments, multilateral and private sector clients in the area of public finance, economics and urban infrastructure development.

In public finance and economics, the work has broadly included budget reforms, revenue augmentation strategies, performance improvement, institutional strengthening, accounting and financial management systems, debt management, and automation or computerisation. In addition, the team has gained traction in the public expenditure and financial accountability/fiduciary risk assessment areas with assignments across South Asia. Our economics sub-group focusses on applied economics services related to macro- and microeconomics, competition, impact assessment and business forecasting.

In urban infrastructure development, our team provides advisory services from planning to implementation, including programme management, business plans and strategies, institutional strengthening, financial management and accounting, and municipal project development, including through public-private partnership (PPP), transaction advisory and contract management.

Most of our projects include training and capacity building of government counterparts working with the project team on specific modules.

Make in India Week, 2016: PwC team along with the Odisha state delegation at the Invest Odisha pavilion

Contacts

Ranen Banerjee
Partner, Public Sector and Governance
PwC India
Building no. 10, 17th Floor
Tower C, DLF Cyber City
Gurgaon - 122 002, Haryana
Tel: + 91 124 3306 009
Fax: +91 124 3306999
Mobile: + 91 9818886207
Email: ranen.banerjee@in.pwc.com

Editorial team

Aashima Verma
Email: aashima.verma@in.pwc.com

Gunjan Bansal
Email: gunjan1.bansal@in.pwc.com

Janki Soneja
Email: janki.soneja@in.pwc.com

Contributors to this issue

Abhinab Mitra
Mehul Gupta
Pooja Singh
Sambit Rath
Shubhika Bilgrami

About PwC

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 157 countries with more than 2,08,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com

In India, PwC has offices in these cities: Ahmedabad, Bengaluru, Chennai, Delhi NCR, Hyderabad, Kolkata, Mumbai and Pune. For more information about PwC India's service offerings, visit www.pwc.com/in

PwC refers to the PwC International network and/or one or more of its member firms, each of which is a separate, independent and distinct legal entity in separate lines of service. Please see www.pwc.com/structure for further details.

pwc.in

Data Classification: DC0

MJ/August2016-7021